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Central Intelligence Agency

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10 August 1987

Near-Term Outlook for East Asian Competitiveness: Spotlight on the NICs 25X1

SUMMARY

This paper, the fourth in a series of regional economic assessments produced by the Directorate of Intelligence, forecasts the East Asian trade surplus over the next two years and highlights the growing importance of bilateral trade relations between the United States and the region's newly industrializing countries--South Korea, Taiwan, Hong Kong, and Singapore. 25X1

As a region, East Asia has transformed its merchandise trade balance with the rest of the world from a deficit of $1.6 billion in 1980 to a surplus of about $105 billion in 1986. Although a majority is accounted for by Japan, most of the recent growth of the surplus is being generated by the region's NICs, a trend that will continue over the next two years. Productivity improvements, continued low regional wage rates, and improved terms of trade should more than offset stronger import demand. 25X1

This memorandum was prepared by Office of East Asian Analysis. 25X1
Information available as of 10 August 1987 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Southeast Asia Division, OEA, 25X1 25X1

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The product pattern of East Asian[1] trade will continue to change to the NICs' benefit during the next two years. Manufactured exports have increased steadily, now accounting for nearly three-quarters of regional exports. This will intensify, in our view, as Japanese producers move further along the cutting edge of technology in microelectronics, advanced structural materials, and other industries, allowing the NICs to expand their sales of steel, electronics goods, integrated circuits, and videocassette recorders in Western markets. Meanwhile, the resource-rich, less developed economies of East Asia--China, Indonesia, Malaysia, Thailand, and the Philippines--will continue to replace the NICs in the production and assembly of low-tech, labor-intensive manufactured exports, such as textiles, garments, and consumer electronics--usually in joint ventures with subsidiaries of US and Japanese companies. [redacted] 25X1

Growing trade surpluses with the United States are forcing regional governments to consider a variety of policy adjustments to correct the imbalance. The NICs especially are under pressure to abandon foreign exchange rate policies that depreciate local currencies against the yen--making their exports more competitive on world markets--by maintaining basic parity with the US dollar. The NICs are opting instead to reduce barriers to Western imports, to liberalize capital markets, and to increase overseas investment. We believe that when the NICs complete the process of realigning their exchange rates to more realistic levels, probably by mid-1988, the region's LDCs will become more competitive with the NICs in third country markets. [redacted] 25X1

The problems caused by the large East Asian trade surplus with the United States will be further compounded by continuing changes in the range of products being traded. Trade across the Pacific increasingly involves high-technology products--such as microprocessors and optoelectronics--in head-on competition with Western manufacturers. This, coupled with further regional diversification across a wide range of product lines, including electronics, steel, textiles, shipbuilding, and machine tools, will intensify existing trade frictions between East Asia, and the United States and Europe. [redacted] 25X6

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[1] In this assessment, East Asia includes: Japan, Australia, New Zealand, Taiwan, South Korea, Singapore, Hong Kong, China, Indonesia, Malaysia, Thailand, and the Philippines. [redacted] 25X1

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East Asia's Trade Offensive

Export-oriented trade and economic policies of many East Asian governments have led to a near doubling of regional exports since 1980 to about $430 billion. Coupled with very modest import growth, East Asia's merchandise trade balance has been transformed from a deficit of $1.6 billion to a surplus of about $105 billion. We believe that the changing product pattern of East Asian trade--as area economies move up the technological ladder--also reflects the region's growing economic maturity. 25X1 25X1

Leadership for the region's trade offensive in recent years has increasingly been provided by the NICs, where market-oriented economic policies produced sufficient flexibility to adjust to changes in the international environment. Singapore, for example, experienced a contraction in 1985 partly because of high-wage policies and an attempt to move too quickly into high-technology industries. The government quickly realized its mistake and took immediate action, including a two-year wage freeze and decreases in required employer social security contributions. 25X1

The NICs' success is largely the result of market-oriented, outward looking economic policies, combined with government programs to support capital formation. The region's economies have, by and large, encouraged private-sector leadership in development, allowing the marketplace to efficiently allocate resources, and creating bureaucracies that are responsive to entrepreneurs. Countries that have tried to counter the market through government intervention have generally had inferior records of trade and development. In the period 1973-85, for example, the Philippines recorded an average annual inflation-adjusted per capita income growth rate of only 1.1 percent, compared with 6.5 percent for Singapore, 6.3 percent for Hong Kong, and 5.4 percent for South Korea. 25X1

We believe the correction of the yen, which has risen as much as 60 percent against the US dollar and NIC currencies has done more than anything else to shift comparative advantage among East Asia's diverse economies in favor of the NICs. At the macro level, we estimate that the higher yen has added as much as $10 billion to the NICs' overall current-account surplus since late 1984. At the micro level the impact of the high yen is vividly demonstrated in textiles, shipbuilding, and steel, where Japanese efforts to move to a higher technological plane in response to weaker profits are being taken advantage of by the region's NICs.

- After zero growth in 1985, for example, textile sales by the seven largest Japanese producers during 1986 fell 10 percent. But Japanese producers continued to diversify product lines and actually expanded sales of higher tech items such as polyester film, a key ingredient in videotapes, synthetic resins, and ultrathin fibers. The net effect, according to Industrial Bank of Japan analysts, is that the industry is surrendering the middle ground to standard filament makers in Taiwan and South Korea. These, in turn, boosted textile exports 25 percent last year despite quotas in many markets.

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- Only two of Japan's top seven shipbuilders reported profits last year, as the price differentials with South Korean shipbuilding yards widened to 40 percent on delivered tonnage. According to press reports, moreover, what earnings Japanese shipbuilders did claim were sourced to nonship enterprises, such as warehousing, trucking, and hotels, into which the industry is increasingly diversifying. As a result, the Japanese Ministry of Transportation expects that 20 percent of shipbuilding capacity will be eliminated by the end of 1988--to the benefit of Singapore, South Korea, and Taiwan, which have tripled their share of global production since 1985 to about one-third of all orders.

- Regional adjustment is most visible in steel, where Japan's five largest producers expect to rack up losses of $2.4 billion in 1987-88. The Industrial Bank of Japan estimates that by 1990 steel production will constitute no more than 2.4 percent of GNP, down from 4.4 percent in 1984, even though Japan is likely to retain the world's largest production capacity at about 90 million tons. Japanese producers are diversifying product lines and are banking on investments in producing new materials, such as carbon black composites, titanium, ceramics, and silicones. As for South Korea and Taiwan, strong domestic consumption estimate the two countries are adding production capacity at a rate of 10 percent annually.

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Depressed oil and commodities prices, low international interest rates, and low labor costs--hourly wages in South Korea, Taiwan, and Singapore, are about $2 per hour, compared with $10 in Japan, and $13 in the United States--also have sharply improved the efficiency of domestic investment, bolstering NIC productivity and export competitiveness. In the last six years the NICs have not only been able to more than double their exports to the United States but have also managed to increase their sales to Japan by 63 percent. Collectively, the NIC current-account surplus now equals roughly 10 percent of their combined GNPs. Japan's large current-account surplus equals roughly one-third of the NICs' in relative terms. 25X1

Pressure For Policy Adjustments

Large surpluses in the NIC's external accounts have produced a wave of East Asian policy initiatives to correct the imbalance. All NIC governments are engaged to some degree in deregulating domestic industry, lowering tariffs, reducing quantitative restrictions on imports, encouraging foreign investment, and privatizing state-run enterprises to improve efficiency. We believe that policy initiatives under way and the continuation of protrade economic policies will lay the foundation for an even greater competitive edge over the long term, while prompting the region's trade- and current-account surpluses to grow during 1987-88. 25X1

First, regional central banks are adopting cautious exchange rate policies designed to promote long-term structural adjustment while protecting their trade accounts over the short term. During 1980-84, not one of the NICs' currencies matched the dollar's appreciation: central bank intervention helped push currencies lower to maintain export competitiveness. Although South Korea and Taiwan have allowed their

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currencies to strengthen somewhat against the dollar since last year, both currencies are still sharply lower in real terms than at the beginning of the decade (see figure - **Indices of Exchange Rates**). Seoul has studied revaluing the won, but the local business community is fearful that such a move would severely damage the financial viability of export enterprises and create widespread unemployment. The same reasoning appears to apply in Taipei-- where half of GNP is exported. Last March, Taipei accelerated measures to liberalize and internationalize Taiwan's trade and financial policies to head off growing US pressure to revalue the currency. Taipei's main concern, however, is to moderate the pace of appreciation of the new Taiwan (NT) dollar to allow local manufacturers, particularly the small- and medium-sized enterprises that dominate the economy, time to adjust. [redacted] 25X1

East Asian Trade Imbalances: The European Perspective

While threatened protectionist barriers in the United States are prompting the region's exporters to divert their exports to Europe, EEC policymakers are discreetly warning East Asian NICs to start showing "more restraint" in their exports. A surge in imports from the NICs of up to 50 percent in 1985 resulted in an estimated $3 billion trade deficit--a three-fold increase over the previous year. EEC officials readily admit, however, that much of this results directly from the decline in the value of the US dollar and related Asian currencies relative to European currencies, which makes Asian goods more competitive in European markets. [redacted] 25X1

Although the EEC has not made public statements urging the region's NICs to revalue against the US dollar, cries of alarm by Europe's textile, steel, and shipbuilding sectors are beginning to alert East Asian countries to the protectionist dangers they may face unless they curb exports. According to figures published by the EEC Confederation of Textile Importers, for example, EEC imports of East Asian garments and textiles grew by as much as 15 percent in the first six months of 1986, and despite a strong desire to liberalize Europe's heavily protected steel sector, the EEC has nonetheless agreed to renew its voluntary restraint pacts with a number of Third-World steel producers, including South Korea, for another year. [redacted] 25X1

As a first step in eliminating what they see as "unfair advantages" given to the NICs under EEC's trade regime, the community recently phased out 11 products exported by South Korea and Hong Kong from its generalized system of preferences--including such products as footwear, gloves, jewelry, electric lamps, quartz watches, and toys. In addition, EEC officials are expected to take tougher and swifter action against counterfeit exports from East Asia. Under a new community "instrument" which gives Europe the right to take action against illicit trading practices by rival exporters, the International Federation of Audiocassette Producers recently requested the EEC to take punitive action against Indonesian exports of counterfeit music cassettes. [redacted] 25X1

[redacted] 25X1

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In our judgment, the NICs can be expected to seek several policy alternatives to avoid sharp corrections of their currencies. Both Seoul and Taipei seem to be leaning to modest capital market liberalization, which would permit local currencies to appreciate gradually. Progress promises to be slow, however. 25X1
Taipei believes that liberalization of exchange controls would expose the NT dollar to speculative pressures that would weaken the currency in the long run. In addition, several economic ministries appear to believe Taipei's massive $60 billion in foreign reserves are required to cushion the NT dollar against possible future speculative outflows. The cabinet in May endorsed proposals that will allow exporters to retain foreign exchange, and local residents to buy foreign financial securities and real estate. Controls on capital inflows, however, which were implemented for the first time in March in an effort to staunch financial speculation, will remain in place. Moreover, even after the new regulations on capital outflows are voted into law by the legislature, foreign brokers and investment bankers will be barred from offering their investment services to local investors. 25X1

Deregulating private capital movements also would encourage direct foreign investment and facilitate technology transfer. South Korea, for example, has undertaken to modernize financial markets to stimulate the inflow of foreign capital, even though the country's changeover to current account surplus status has drastically reduced the country's foreign capital requirements. Seoul's modernization efforts--which by 1990 will allow foreigners to invest directly into Korean securities--are prompted by Seoul's concern over its ability to act as prime allocator of capital, soaring debt-to-equity ratios for Korea's conglomerates, and a foreign debt burden of $43 billion. 25X1

The NICs are also avoiding sharp currency revaluation by initiating selected tariff reductions. Taiwan and South Korea, for example, have taken modest steps to scale back tariff and quantitative restrictions on a number of imports. South Korea, has adopted a reform package that cuts tariffs on about two-fifths of its imports--from an average of around 23 percent in 1983 to 17 percent by 1988. What is more, many imports formerly subject to license now receive automatic approval. Other concessions include opening the domestic market to foreign cigarettes and the US insurance industry. 25X1

Last April, Seoul announced a reform package--which includes a $2.5 billion fund to stimulate imports from countries with which South Korea has a trade surplus, accelerated import liberalization, and reduced export incentives--designed specifically to slow the growth of its current account surplus with the United States. South Korean tariffs on agricultural commodities and processed foods, nevertheless, remain as high as 60 percent, and beef, citrus fruit, and seafood imports are subject to quotas or outright bans. Moreover, a host of manufactured goods--from competing foreign auto parts to machine tools and personal computers--are kept out through burdensome licensing and administrative requirements. 25X1

On the export side, Seoul is limiting the volume of textile and apparel exports to the United States to an average annual growth rate of about 1 percent over the next four years. South Korea, Singapore, and Taiwan are also moving in response to foreign complaints of piracy by enacting more effective protection and enforcement of foreign

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patents, trademarks, and copyrights. This is especially necessary for Taiwan, where the introduction of sophisticated technology by foreign firms has been discouraged by inadequate intellectual-property protection. 25X1

Finally, rising current-account surpluses and growing fears of protectionist legislation in the United States, Europe, and elsewhere, are accelerating East Asian direct overseas investment. In late 1986, for example, the South Korean Minister of Trade and Industry said the government would assist companies planning to establish overseas production facilities-- particularly in the United States.[2] This tactic follows the Japanese pattern of establishing a physical presence in the vicinity of primary consumer markets--partly to short-circuit protectionist barriers, and partly to stifle criticism of unfair trade practices by creating local employment opportunities. 25X1

Assessing East Asia's 1987-88 Global Surplus

We believe the NICs' choice of trade liberalization measures and financial deregulation to obviate the need for sharp exchange rate adjustments means that the region's surplus will grow further before showing any signs of shrinking. The currency appreciation we judge commensurate with the rapid accumulation of foreign exchange reserves in Taiwan and South Korea would mean sharp and immediate reductions in the profitability of a broad range of exports. Tariff reforms, in contrast, will confine necessary price adjustments to a narrow range of goods, while financial reforms will appreciate East Asian currencies gradually at best. Based on our analysis of East Asian policy initiatives and recent trends in Western competitiveness, we thus believe the NICs combined trade surplus will surpass $20 billion by 1988, pushing the region's as a whole to $110 billion. 25X1

Expansion of the surplus will be somewhat slower than the previous two years, as import growth runs somewhat ahead of that of exports. Planned increases in investment expenditure over the next two years should, for example, boost South Korea's and Taiwan's real imports by over a third in the form of new orders of capital and intermediate goods, as well as industrial components and raw materials. The expected increase in NIC investment activities should provide a good opportunity for US producers to expand their exports of capital goods to the NICs, not only because

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2 Nervousness over Western protectionist legislation is especially keen in South Korea's electronics and automobile industries. In response to the EEC's decision to raise tariffs on video cassette recorders by as much as 14 percent prompted, for example, two of the country's manufacturing giants, Goldstar and Samsung, announced plans to set up assembly operations in West Germany and Great Britain. This follows a similar announcement by Hyundai Motor Company to build a car-assembly plant in Canada following hints from Ottawa that tariffs on its cars might be raised. In another instance, worries about the future of steel exports to the United States prompted Pohang Iron and Steel to announce plans to make the single largest foreign investment ever by a South Korean company--a fifty-fifty joint venture with US Steel in which $400 million will be invested to modernize and expand US Steel facilities in the United States. 25X1

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imports overall are increasing rapidly, but also because the fall of the US dollar gives US producers a new edge against the traditional Japanese dominance in these markets. [redacted] 25X1
[redacted] 25X1

Regarding NIC exports, we believe sales will rise at a somewhat slower pace than in 1985 and 1986 partly because of market saturation in some Western markets--notably automobile exports to Canada. We estimate that NIC exports will expand from about $131 billion last year to around $160 billion by 1988. As in the recent past, the key factor for the NICs' continued export success will be improved competitiveness from a continued favorable foreign-exchange-rate environment. The rate of export expansion will be somewhat slower than in 1986 because of a projected 5-10 percent trade-weighted revaluation of NIC currencies against the dollar in response to Western pressures to realign exchange rates. [redacted] 25X1

Improved performance by the NICs will not come entirely at the expense of Japan. Improved terms of trade should enable Japan to add marginally to its global trade and current account surpluses despite the slowdown in real exports because of increased competition from the region's newly industrializing superstars. We judge that without a further dramatic yen appreciation and sharp adjustments in fiscal policy in Japan and the United States, Japan's overall trade balance will expand by about 5 percent annually over the next two years--to around $90 billion in 1988. Although weak export volume will continue to bridle Japanese economic performance, stronger consumer demand and a large supplementary budget should result in slightly improved economic growth--around 3 percent this year and 3.5 percent in 1988. [redacted] 25X1

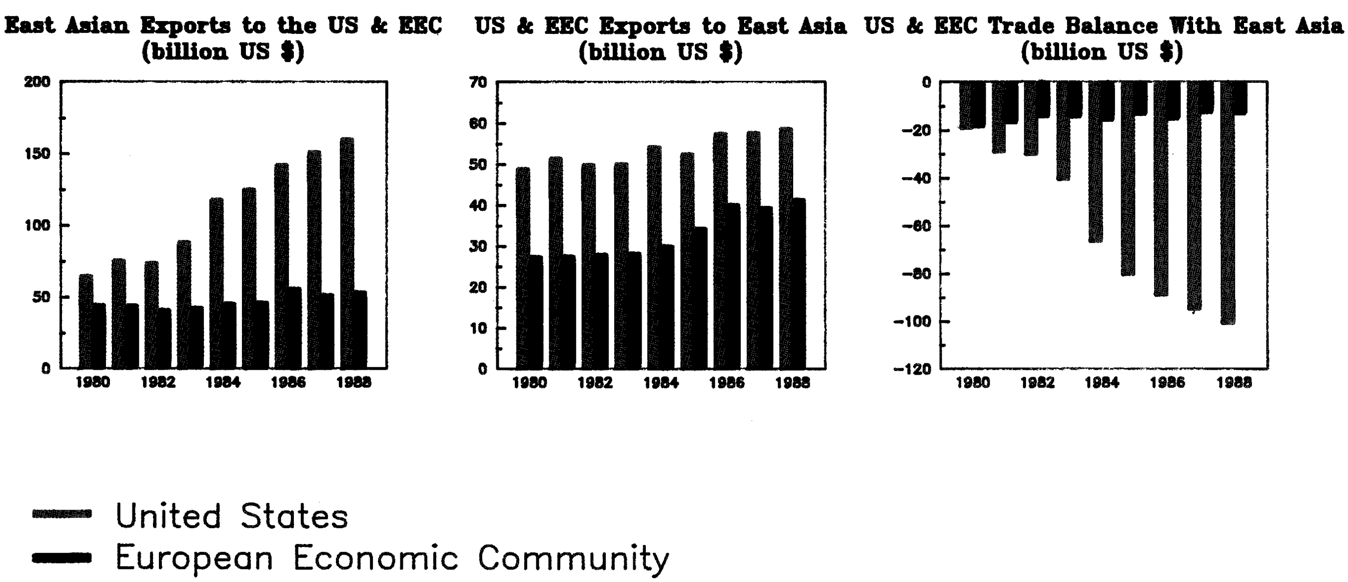
Implications

In the short term, improvements in East Asian competitiveness resulting from market-oriented trade policies will continue to pose challenges to US trade fortunes. East Asia's overall surplus with the United States will continue to be dominated by Japanese exports, but Japan's market share will be smaller than the two-thirds share it captured last year as a result of growing competition from the NICs. Although the increase will be slowed by the strengthening of local currencies against the dollar, we estimate the NICs' trade balance with the United States will top $35 billion by 1988, up from about $3.5 billion in 1980. [redacted] 25X1

Trade across the Pacific will increasingly involve high-technology products in head-to-head competition with large US manufacturers. Last year, for example, as an appreciating yen added $1,300 to the price of the average Japanese car in the US market, automobile production in South Korea topped 455,000 units, nearly half of which were exported to the United States. For 1987, Korean automobile manufacturers expect to produce 860,000 units, and exports to the United States are expected to reach 470,000 vehicles. Similar regional diversification in a host of product lines--including electronics, steel, textiles, shipbuilding, machine tools, and others--will only add to the regional trade surplus, threatening to heighten trade frictions. [redacted] 25X1

[redacted] 25X1

Figure 1



a. 1986 estimated; 1987-88 projected

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East Asian Auto and Electronics Industries: Where Are They Headed?

Japanese technology transfer within the region--a byproduct of Japanese efforts to remain competitive by "outsourcing" component assembly operations--is improving overall East Asian competitiveness in automobiles and electronics, two industries that, unlike steel, shipbuilding, and textiles, Japan will continue to dominate. From the US perspective, however, the effect will be the same--increased competitive pressure by East Asian states on large domestic industries. [redacted] 25X1

As Japan is deemphasizing consumer electronic products in favor of industrial electronic systems, the beneficiaries are proving to be the region's NICs. South Korean exports of videocassette recorders to the United States reached 2.6 billion units in 1986, while IBM-compatible personal computers, which use Japanese-manufactured integrated circuits, have risen sharply in a sluggish US market. Meanwhile, TDK, a large Japanese electronics firm, boosted production of tapes and other consumer products in subsidiary plants in Taiwan and South Korea last year by 30 percent in response to the strong yen. For the same reason, Toshiba announced last October that it would relocate half of its color television production to Singapore. [redacted] 25X1

In the auto industry, Japan's increasing concentration on higher performance and luxury models has paved the way for exports at the lower end of the product line by South Korea's Hyundai. Hyundai even anticipates exports to Singapore, Hong Kong, and Taiwan, according to US Embassy reporting. But the firm remains uncompetitive in Japan, largely as a result of a dependence on Japanese firms for the production of complicated subsystems such as engines and transmissions. [redacted] 25X1

In the past year or so, Toyota, Mitsubishi, Fuji Heavy Industries, and Isuzu have entered into joint ventures, technical cooperation agreements, and outright equity purchases with automobile firms in Taiwan. Japanese car makers are hoping to cut yen-bloated car prices by building up the local content of their Taiwan models. For its part, Taiwan's car industry will receive a big boost in its long-term goal of developing its automobile export potential-- a goal dictated, in large measure, by national pride and a sense of competition with South Korea. The current intraregional trade pattern--featuring the supply to Japan of simpler parts, outsourced from Japanese firms because of low value added--will probably persist for the next five years or so. [redacted] 25X1

[redacted] 25X1

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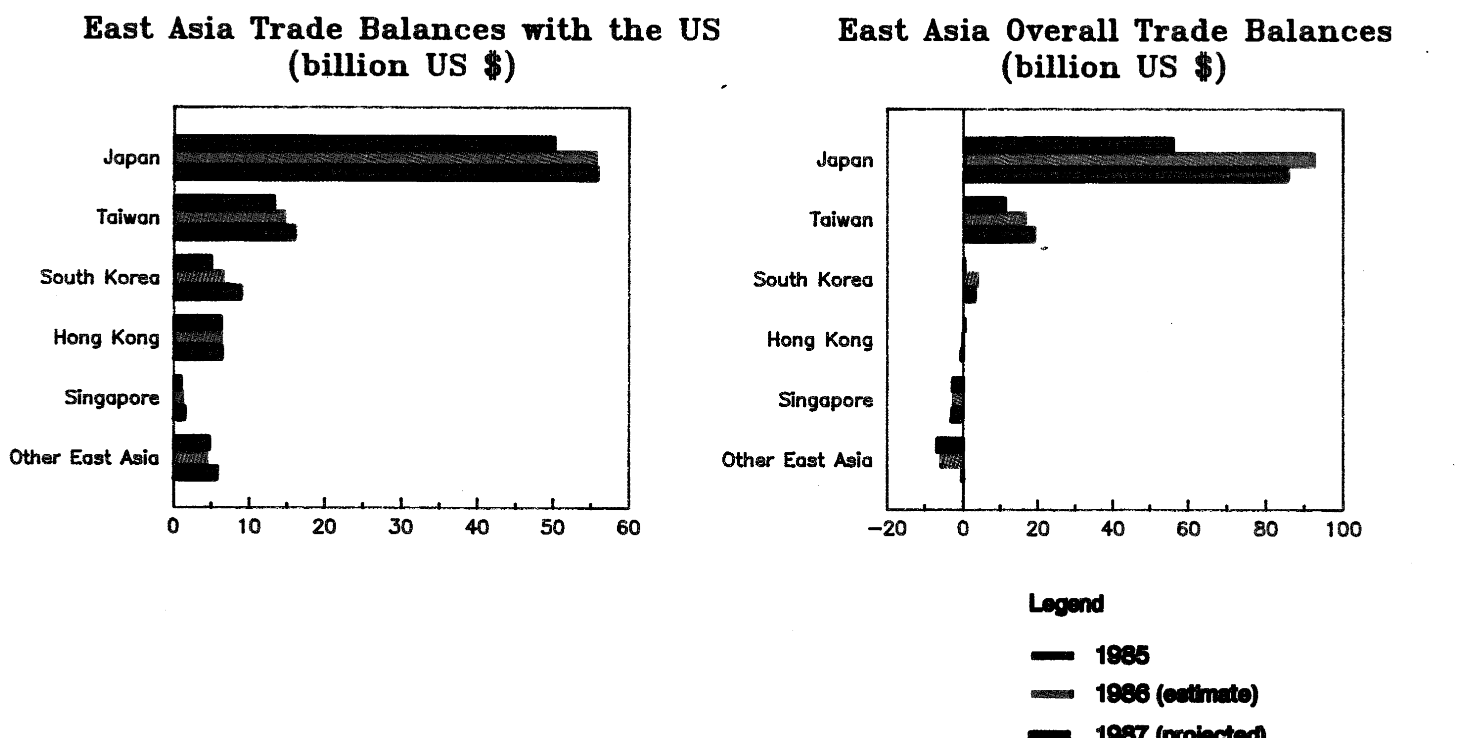
Figure 2



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Although we expect modest increases in area purchases of Western products, NIC economies will concentrate their foreign purchases on high-quality and price-competitive Japanese capital and consumer goods. As a result, the NICs will continue to register large trade deficits with Japan--roughly equal to the $18 billion of 1986--while running huge offsetting surpluses with the United States. Goods in which the West has a comparative advantage--mainly agricultural products -- will continue to face stiff entry barriers as regional governments endeavor to protect local industry from foreign competition. Indeed, those products affected by recent tariff and quota reductions have, for the most part, excluded exports in which the United States has a comparative advantage. As for products that have been touched by deregulation, the West will remain at a competitive disadvantage with comparable Japanese products because of lower transport costs and superior delivery and servicing schedules. 25X1

Over time, however, we believe that East Asia will continue toward more openness in trade, including further reductions in import barriers--providing greater market access to foreigners and more export-oriented economic policies. As the relationship expands to include exchanges of labor-intensive and lower technology consumer goods for more capital-intensive and technology intensive goods, we believe that the United States will reap an increasing share of the benefits. Prospects for US sales in East Asia are especially promising in knowledge-intensive and high-technology products such as coal-mining and oil-extraction equipment, hydroelectric plants, locomotives, aircraft, and computers. 25X1

Further trade liberalization measures--although restraining trade- and current-account surpluses in the short run--will make East Asia a more formidable presence in international markets as time passes by forcing the streamlining of production and shifting of productive resources as market forces dictate. Financial and tariff liberalization measures by East Asian economies will also contribute to even stronger currencies in the early 1990s by improving the efficiency of their manufacturing sectors. 25X1

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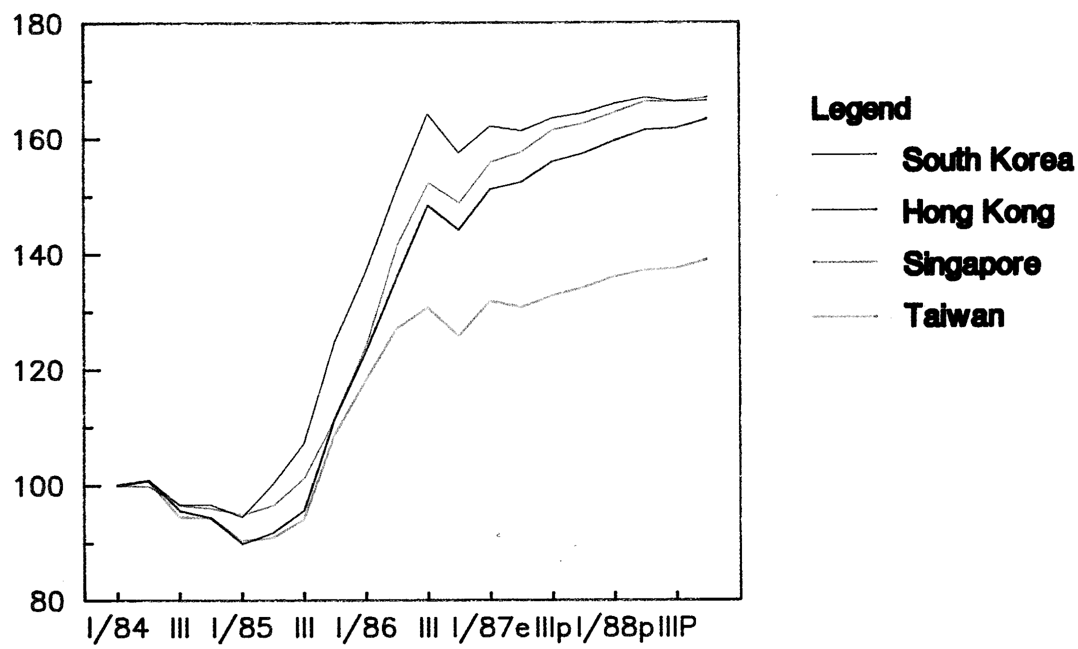
Figure 3

Indices of Exchange Rates (NIC Currencies Per Yen, I/1984=100)



e – Estimate
p – Projected

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Appendix

East Asia: Financing Investment

Noninflationary fiscal and monetary policies, and rapid employment and output growth through export-oriented economic policies, are further reinforced by high rates of savings and investment. East Asian GDP as a percent of US GDP grew steadily from just over 60 percent in 1975 to almost 80 percent in 1985. During that period real gross fixed investment expenditures in East Asia slightly exceeded that in the United States. The reason is that investment expenditures in 1985 absorbed about 27 percent of GDP in East Asia, compared with only 19 percent in the United States. [redacted] 25X1

Higher levels of investment spending in East Asia are made possible by higher rates of both public and private savings. In 1985, national savings in East Asia amounted to 28 percent of GDP, compared with only 14 percent in the United States. In the NICs, where the government takes an active development role, private savings in 1985 reached $76 billion; with $60 billion in investment, the remainder was used to build up international reserves, retire foreign debt, or invest abroad. Average national savings rates in Hong Kong and Taiwan exceed 30 percent of GNP, and Singapore's record-breaking 47-percent savings rate in 1986 owes much to a mandatory employee savings plan. Even in Hong Kong and Taiwan, where in recent years the rates of capital formation has been in decline, national savings in 1986 were holding their own. As a result, Hong Kong has been exporting capital and Taiwan has amassed huge international reserves. Although South Korea fell short of savings self-sufficiency after the first oil price shock, its national savings have increased significantly, equalling one third of GNP in 1986. [redacted] 25X1

East Asia's Foreign Debt: Less a Problem as Time Passes

Between 1979 and 1986, we estimate that the long- and short-term indebtedness of East Asia's developing economies ballooned nearly 146 percent, to $194 billion. The region's newly industrializing countries witnessed a $33 billion jump in their foreign indebtedness to almost $64 billion, while East Asia's less developed economies recorded an almost threefold increase, to about $130 billion. The pattern of debt accumulation between these two groups in the past few years reflects the countries' different stages of economic development. [redacted] 25X1

As the economies of the East Asian NICs have taken off by virtue of the export boom, they have become less reliant on foreign savings to finance growth. After 1983, for example, large and growing current account surpluses enabled this group to cease being a net importer of foreign capital to become a net exporter. While foreign debt continued to rise, its rate of growth has decelerated sharply, with much of the increase being attributed to build-ups in official international reserves. Between 1983 and 1986, for example, this group's foreign indebtedness rose an average of only $2 billion yearly-- compared with the period of 1979-82, when the group's foreign debt increased over $5 billion annually. [redacted] 25X1

[redacted] 25X1

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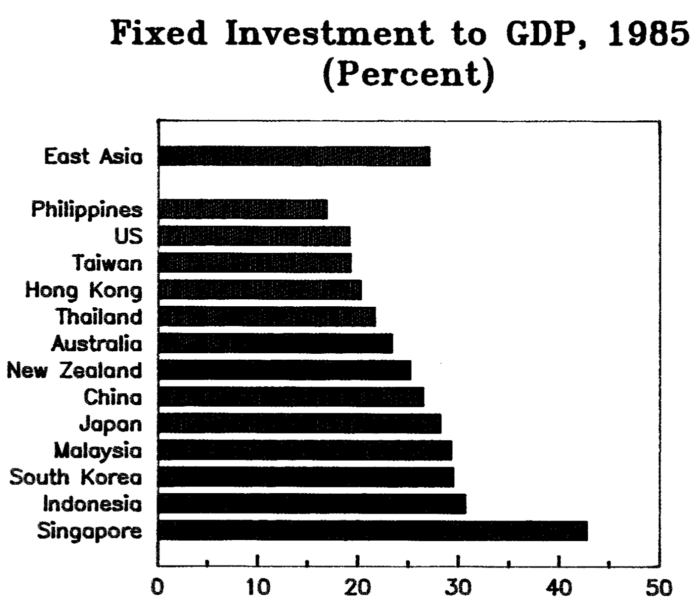
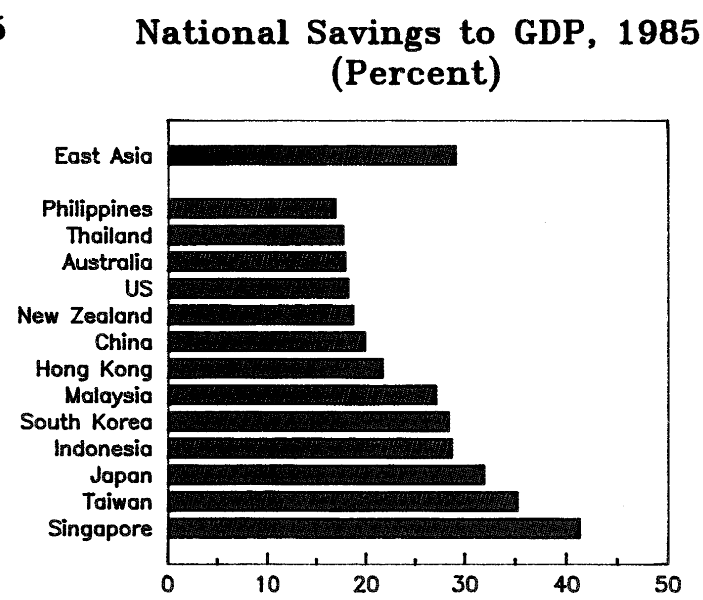
Figure 4





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The major success story within the group of East Asian NICs is South Korea. Traditionally a current account deficit and capital importing country, since late 1985 South Korea has run trade surpluses for the first time in its modern history--about $3.5 billion in 1986. South Korea's current account surplus-- $4.6 billion in 1986--is forecast to grow as much as $500 million in 1987. This will enable the country to start running down its stock of external debt--estimated in excess of $50 billion in 1986--especially by allowing short-term credit lines to mature. This will be an historic event: the first example of a developing country that borrows heavily, uses the money to build a modern industrial base, and then uses that base to pay off its obligations. 25X1

The East Asian less developed economies, on the other hand, are typical of developing economies attempting to build a modern economic base, while at the same time being handcuffed by low prices for commodities exports. Although savings rates are generally higher than in the West, the region's LDCs are forced to import capital in relatively large doses to finance government-sponsored development schemes. Unfortunately, many such programs concentrate on import substitution rather than manufacturing for export. The result is that export growth is insufficient to service interest payments on new debt, which aggravates the current account deficit. 25X1

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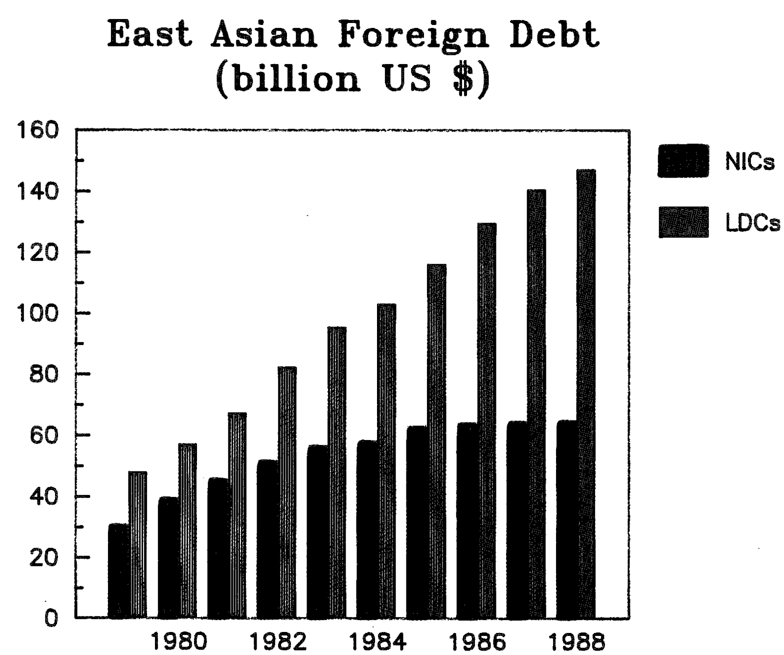
Figure 5



a. 1986 estimated; 1987-88 projected.

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NEAR-TERM OUTLOOK FOR EAST ASIAN COMPETITIVENESS: SPOTLIGHT ON THE NICS

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